UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re: SRC Holding, Inc., et al., Chapter 7

Debtor. File Nos.: 02-40284-02-40286

Brian F. Leonard, as Trustee, Adversary No.: 04-4117

Plaintiff,

vs.

Spielo Manufacturing Inc., Oral Argument Requested

Defendant.

TRUSTEE'S RESPONSE TO MOTION TO WITHDRAW REFERENCE OF ADVERSARY PROCEEDING

The Trustee, through his undersigned counsel, submits this response in opposition to the Defendant's motion to the United States District Court to withdraw reference. Just as the Bankruptcy Court, after fully considering the matter, denied the Defendant's request for transfer, so should this Court deny Defendant's request for withdrawal of reference.

This case is a core proceeding involving fraud on the Trustee in his capacity as Trustee. The Trustee has chosen a legitimate and proper venue for his action and that choice should be accorded deference. There is, moreover, no need for an immediate transfer as this case can remain in the Bankruptcy Court until it is trial ready. Any similarities between the present case and the "Frank Lawsuit," which, contrary to Defendant's assertions, are largely limited to the

legal claims and not the factual allegations, do not mandate consolidation of the two cases. The Defendant's motion should be denied.

FACTUAL BACKGROUND[1]

The Trustee, in his Amended Complaint, alleges, in summary, as follows: In 1994, Miller and Schroeder Financial, Inc. (now Securities Resolution Corporation) ("**MSF**") underwrote and sold a private placement of Spielo securities (the "**Private Placement**"); in connection with the Private Placement, MSF was granted a number of warrants to purchase stock of Spielo (the "**Warrants**"); the Warrants were owned by MSF on January 22, 2002, the date MSF filed its petition under Title 11 of the United States Code and became property of MSF's bankruptcy estate; on December 6, 2002, Defendant's Chief Financial Officer telephoned the Trustee and said that the Defendant wanted to purchase the Warrants at the price of $1.50 per Warrant and represented that Defendant had 2,691,175 shares outstanding, had a shareholder equity of $14,556,563, and that Defendant did not intend sell its shares and that no market for the company's shares or the Warrants existed; Defendant supported these representations with financial statements; the CFO said that Defendant merely wanted to "clean up its balance sheet"; and the Trustee, in reliance on the statements and representations and the financial statements, agreed to sell the Warrants to Defendant.

The factual allegations made in the Frank Lawsuit are quite different from those made in the present case. The Frank Lawsuit involves three plaintiffs, one from Minnesota and two from

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[1] This section is, in large part, identical to that in the Trustee's response to the Defendant's motion for transfer made to the Bankruptcy Court. This motion, however, is virtually identical to that motion and, therefore, at the risk of redundancy, the facts are repeated here for the convenience of this Court.

Wisconsin. *See* Frank Lawsuit Complaint, Exhibit A to Defendant's Memorandum, at ¶¶ 2-3. The Frank plaintiffs have alleged that they exercised their warrants and became shareholders, but were later induced to sell their shares back to the Defendant as a result of misrepresentations concerning regulatory and licensing requirements relating to gaming operations. *Id*. at ¶¶ 16-23. One of the plaintiffs traveled to Defendant's headquarters and had discussions with the Defendant's CFO. *Id*. at ¶¶ 14. There is also an allegation that Defendant sent out a letter that included misrepresentations. *Id*. at ¶¶ 20 and 21. The Frank plaintiffs also allege that various telephone conversations took place between Defendant's CFO and the plaintiffs. *Id*. at ¶¶ 17-19.

The fraudulent statements made to the Frank Lawsuit plaintiffs were not the same as those made to the Trustee. There is also an important difference in the legal claims. The Frank plaintiffs have alleged claims under the federal securities laws, the Wisconsin securities laws, and have also, as shareholders, alleged a breach of fiduciary duty. Those claims are not found in the Trustee's Amended Complaint. The federal claims in the Frank Lawsuit, moreover, have already triggered a motion to dismiss based on the Private Securities Litigation Reform Act and a motion to amend the complaint. Those motions, along with the mandatory Rule 26 disclosure procedures, will result in delay of the Frank lawsuit that will not occur in the Trustee's case. In the Trustee's case, the defendant has recently filed an answer to the Amended Complaint and it is expected that the Court will shortly issue a scheduling order. The order will, as is the usual case in adversary proceedings, waive the Rule 26 mandatory disclosure procedures. The Trustee

has, moreover, already served a subpoena on a third party witness (agreeing to defer the time for the deposition at the request of Defendant's counsel), and is otherwise proceeding with discovery.

ARGUMENT

This is, despite the Defendant's unsupported assertion to the contrary, a core proceeding and the Bankruptcy Court has the authority to hear and determine core matters. The Trustee has chosen a legitimate forum and his choice is entitled to deference.

In asking the Bankruptcy Court to transfer the case, the Defendant's focus was on the right to a jury trial and the argument that the Bankruptcy Court should not consider matters involving non-Code statutes. Now that the Bankruptcy Court has denied the motion for transfer, the Defendant's focus has shifted, even though the Bankruptcy Court also rejected this argument, to questions of judicial economy. The two cases are not, however, as similar as the Defendant suggests. A transfer to the District Court and consolidation with the Frank Lawsuit will not serve the interests of judicial economy, but rather, will likely result in the Trustee's case being delayed. Such a delay may impact the entire bankruptcy proceeding, not just this action. The Trustee is entitled to his choice of forum.

I. THIS CASE IS A CORE PROCEEDING

This case is a core proceeding and the Trustee has chosen a legitimate forum for his claims to be heard and decided. The conduct giving rise to the present case arose after the petition and involved the fraudulent inducement of the Trustee to sell Estate assets. When claims arise during the administration of an estate, adversary proceedings based on those claims are core proceedings. *See In re O'Sullivan's Fuel Oil Co.*, 88 B.R. 17, 20 (D. Conn. 1988) and

cases cited therein. This case, moreover, involves the liquidation of an Estate asset. *See* 28 U.S.C. § 157(b)(2)(O). This case is a core proceeding and the Bankruptcy Court has jurisdiction over all aspects of the case and is able to make final rulings.

A plaintiff's choice of forum should not be disturbed, absent compelling reason. *See e.g.*, *Gulf Oil Corp. v. Gilbert*, 330 U.S. 501, 508, 67 S.Ct. 839, 843, 91 L.Ed. 1055 (1947)(claim of forum *non conveniens*); and *Midwestern Distribution, Inc. v. Paris Motor Freight Lines, Inc.*, 563 F. Supp. 489, 491-492 (E.D. Ark. 1983) (motion for remand granted). The present case involves fraud upon the Trustee in his capacity as Trustee administering the assets of the Bankruptcy Estate. It is a core proceeding. The Bankruptcy Court can, and has, the authority to make final and determinative rulings, and the Trustee's choice of forum should be given deference.

II. A JURY TRIAL DEMAND DOES NOT REQUIRE IMMEDIATE WITHDRAWAL

Defendant's demand for a jury trial, and refusal to consent to that trial being conducted in this Court, does not require immediate withdrawal of reference. As Judge Kishel held in *In re Mathews*, 203 B.R. 152, 161 (Bankr. D. Minn. 1996), the Bankruptcy Court has full authority to conduct the case until it is trial ready and to hear all motions that do not entail triable fact questions. Virtually every case cited by defendant supports the conclusion that transfer should occur only after the case is trial ready. *See* Defendant's Memorandum at p. 5-6. Nothing about the present case suggests that the procedure here should be any different.

Defendant's motion is based on 28 U.S.C. § 157(d). Analysis of the motion requires a determination as to whether the Bankruptcy Court would be required to make a "substantial and material consideration" of federal laws or statutes. *See Wittes v. Interco, Inc.*, 137 B.R. 328, 329

(E.D. Mo. 1992). Withdrawal is mandated only if the Bankruptcy Court is, in fact, required to undertake such consideration. The claims here, however, are straightforward, involving state statutory and common law, and will not involve "substantial and material" interpretation of federal law. (Even under the original complaint, as the Bankruptcy Court recognized, it would not have been called on to interpret non-Code federal law or statutes). This case is, moreover, a core proceeding and the Bankruptcy Court has the authority to make final rulings.

III. WITHDRAWAL OF REFERENCE WOULD NOT SERVE THE INTERESTS OF JUSTICE OR ECONOMY

Transfer of this case to the District Court would not be in the interests of justice or economy. The Defendant's assertion that the present case is "virtually identical" to the Frank Lawsuit is not supported by the facts and, consequently, did not persuade the Bankruptcy Court to transfer the case. Transfer of this case, moreover, will likely result in significant and unnecessary delay.

The facts of this case differ from those in the Frank Lawsuit. The plaintiffs are different (shareholders versus warrant holder), the misrepresentations are different (regulatory requirements versus financial position and value of warrants; and in person, via telephone and by letter versus telephone and company documents), and the damages may be different (share value versus warrant value). While there may be, as in any case, some overlap of general discovery, there is no overlap as to the particular facts.

Defendant's attempts at showing the similarity of the two cases, in fact, exposes the differences. Defendant is forced, for example, to expressly highlight the different sale dates and the different securities sold. *See* Defendant's Memorandum at p. 7. Defendant then notes that the same corporate officer is involved in both cases, but fails to mention that the nature of the

representations were entirely different and that they were made at different times and by different methods. *See* Defendant's Memorandum at p. 8. The motive of the Defendant in seeking to obtain the warrants and shares may be the same, but the actual facts of each case are quite different.

The fact of the Frank lawsuit and the misrepresentations made there does not mean that the two cases are "one and the same." The Trustee may inquire as to whether Defendant made certain statements to others about the reason for buying up securities, but that inquiry does not result in the cases becoming identical. The misrepresentations made to the Trustee were not those made to the Frank Lawsuit plaintiffs. The facts of each case are unique.

The present case, moreover, will likely suffer unnecessary delay if there is a withdrawal of reference. As noted above, the Frank Lawsuit has apparently engendered procedural wrangling that is not present in this case. The Trustee's complaint was amended, in part, to avoid much of this time consuming procedural jousting. Here, the Defendant has answered the Amended Complaint and the Bankruptcy Court will soon enter a scheduling order. That order will, as all such orders do in adversary proceedings, dispense with the Rule 26 mandatory disclosure requirements and allow the parties to immediately proceed with discovery. The Trustee, in fact, has already begun the discovery process in this case. The Bankruptcy Court, moreover, in denying the motion to transfer, considered the Trustee's argument that any delay in an adversary proceeding may well have an impact on the administration of the estate. Where the choice of forum is legitimate and delay, not economy, may be occasioned if the case is transferred, there should be no withdrawal of reference.

CONCLUSION

For the reasons set forth above, the Trustee respectfully requests that the Defendant's motion to the United States District Court to withdraw its reference of the above-captioned adversary proceeding be denied.

LEONARD, O'BRIEN
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Dated: May 17, 2004

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Defendant.

PROPOSED ORDER

The above-entitled matter came on for hearing before the Honorable _____ _____, Judge of the United States District Court for the District of Minnesota, on the____day of _____, 2004. Thomas C. Atmore, Esq, appeared on behalf of Plaintiff Brian F. Leonard, as Trustee. Michael E. Keyes, Esq. and David E. Runck, Esq. appeared on behalf of Defendant Spielo Manufacturing Inc.

Based upon the arguments of counsel and all of the files, records and proceedings herein,

IT IS HEREBY ORDERED that Defendant Spielo Manufacturing Inc.'s motion to withdraw reference of the above-captioned adversary proceeding is hereby DENIED.

BY THE COURT:

Dated: _____

_____
Judge of United States District Court

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